**UNITED STATES OF AMERICA**
**BEFORE THE**
**FEDERAL ENERGY REGULATORY COMMISSION**

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| Exelon Generation Company, L.L.C. | Docket No. | ER00-3251-000<br>ER00-3251-001 |
| PECO Energy Company | Docket No. | ER99-1872-002<br>ER99-1872-003 |
| Commonwealth Edison Company | Docket No. | ER98-1734-002<br>ER98-1734-003 |
| Horizon Energy Company | Docket No. | ER98-380-012<br>ER98-380-013 |
| AmerGen Energy Company, L.L.C. | Docket No. | ER99-754-004<br>ER99-754-005 |
| AmerGen Vermont, L.L.C. | Docket No. | ER00-1030-001<br>ER00-1030-002 |
| Unicom Power Marketing, Inc. | Docket No. | ER97-3954-012<br>ER97-3954-013 |
| Unicom Energy, Inc. | Docket No. | ER00-2429-001<br>ER00-2429-002 |

# REQUEST FOR REHEARING OF THE ILLINOIS COMMERCE COMMISSION

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.713, the Illinois Commerce Commission ("ICC") hereby submits its Request for Rehearing of the Commission's "Order Granting Market-Based Rate Authority, Accepting Tariffs, Service Agreement And Power Purchase Agreement, And Waiving Code Of Conduct" issued November 8, 2000 ("Nov. 8, 2000, Order") in the above-captioned proceedings. The ICC is directed by Illinois law to "act to promote the development of an effectively competitive electricity market that operates efficiently and is equitable to all consumers." 220 ILCS 5/16-101A(d). This statutory direction is based on the Illinois General Assembly's finding that "a competitive wholesale and retail market must benefit all Illinois citizens." Id. Therefore, even during the retail rate freeze period, the ICC is concerned with the development of competitive wholesale and retail markets which includes both the availability of alternative generation supply and reasonable (i.e., competitive) prices for that generation supply. The ICC's Request for Rehearing is directed toward this goal.

## I. Specification of Errors for Rehearing

The Commission's November 8, 2000 Order erred in:

1) failing to adopt a delivered price test form of market power analysis to be applied to ComEd's service area in 2003 based on an erroneous conclusion that the ICC's Comments concerning market power are premature and that the ICC seeks *future* relief; and

2) not addressing the ICC's affiliate code of conduct Comments and waiving the affiliate code of conduct requirements in their entirety.

## II. Background

On July 24, 2000, Exelon Generation Company, L.L.C. ("Exelon Generation"), PECO Energy Company (PECO Energy"), Commonwealth Edison Company ("ComEd"), Horizon Energy Company, AmerGen Energy Company, L.L.C., AmerGen Vermont, L.L.C., Unicom Power Marketing, Inc., and Unicom Energy, Inc., (collectively, "Applicants" or "the Exelon Companies") tendered for filing the Application of Exelon Generation for Market-Based Rate Authority and the Application of Exelon Corporation Subsidiaries and Affiliates for Other Forms of Relief under Section 205 of the Federal Power Act ("FPA"), 16 U.S.C. §824d. The Applicants made a number of requests for relief, both with regard to themselves as individual applicants and on behalf of Exelon Corp. and Exelon Generation.[1] In relevant part, the Applicants asked the Commission to grant Exelon Generation market-based rate authority for sales of electric capacity, energy and, in certain markets, ancillary services. Application at 1-2, 7-18. Also, the Applicants requested a waiver of the Commission's inter-affiliate power sales pricing limitations and code of conduct rules, including the affiliate power brokering rules. Id. at 3, 19-28.

On September 1, 2000, the ICC filed Comments in this proceeding, stating its concern that the granting of the Applicants' requests may have an adverse effect on the wholesale and retail markets in Illinois. In summation of its concerns, the ICC stated:

> [A] grant of the Applicants' requests for market-based rates and waiver of inter-affiliate power sales pricing limitations and code of conduct rules, including the affiliate power brokering rules, could result in increased wholesale prices due to wholesale market power that will be passed on to Illinois retail consumers in the form of increased future retail service rates. The ICC is also concerned that the exercise of market power in the wholesale markets will hinder the 'development of an effectively competitive electricity market that operates efficient and is equitable to all consumers,' in opposition to the directives of the Illinois Customer Choice Law.

ICC Comments at 8. To remedy these concerns, the ICC recommended that the Commission condition any grant of relief on the following:

1) a *de novo* review of the Applicants' requests for market-based rate authority when the Applicants file their updated analysis in 2003;

2) a requirement that the Applicants perform and submit the Market Power Analysis described in the Commission's Order 592 Merger Policy Statement Appendix A with respect to the ComEd service area at the *de novo* review of the Applicants' market-based rate authority request in 2003 or, in the alternative, to establish a technical conference to be held

[1] Although Exelon Corp. and Exelon Generation were not yet formed or in existence at the time of the Application, for ease in reference, the balance of this Request for Rehearing is drafted as though Exelon Corp. and Exelon Generation existed and made the specific requests on their own behalves.

in Chicago, Illinois, within the next three months at which an acceptable alternative market power analysis can be developed; and

3) the rejection of Applicants' request to waive the employee separation and power market information aspects of the Commission's code of conduct and the rescission of any waiver of the Commission's inter-affiliate non-power goods and services transaction rules prior to the beginning of the test year that ComEd will utilize to establish bundled retail sales rates in Illinois to be applicable following the expiration of the statutorily mandated retail rate freeze in Illinois.

ICC Comments at 9.

Subsequently, on November 8, 2000, the Commission issued an Order wherein it declined to discuss the ICC's concerns or recommendations, and granted in total the Applicants' requests. In regard to the ICC's recommendation that the Commission reject the Applicants' request to waive the employee separation and power market information aspects of the Commission's code of conduct, the Commission summarily rejected the ICC's recommendation with no discussion. Nov. 8, 2000, Order at 13. The Commission rejected the ICC's remaining recommendations based on a decision that the ICC only requested "future relief" and that the ICC's concerns and recommendations were premature. Id. In relevant part, the Commission's November 8, 2000, Order states as follows:

> The Commission has waived the code of conduct requirements for Exelon. Further, the Commission will deny the Illinois Commission's requests for future relief. At this time it is impossible to know what actions will be appropriate in 2003 or later with regard to Exelon's market power analysis or related questions, and the Commission will take any action necessary based on the state of the market and the Commission's practice regarding market power analysis at that time.

Id. (emphasis added). Rehearing of the Commission's Nov. 8, 2000, Order is necessary in all of these respects.

## III. Discussion

### A. The ICC's Concern and Recommendation Concerning Market Power Is Not Premature and the ICC is Seeking Current Relief in the Form of Immediate Adoption of the Delivered Price Test Applicable to Exelon's Required 2003 Market Analysis Filing.

The Commission dismissed the ICC's concern and recommendation with respect to market power on the general conclusion that it is premature and that the ICC is seeking only *future* relief. In making this conclusion, the Commission erred. As the ICC stated in its Comments with respect to market power:

> The ICC's concern and request is not premature. The Commission must specify *now* the market power standard to be applied to the ComEd service area in the year 2003 and make clear the results of that market power analysis that will be sufficient to permit Exelon Generation to continue to retain market-based rates after 2003 . . . . [footnote omitted] Only by clarifying its intent at this time will the Commission provide all parties with sufficient time to take steps to satisfy that standard or, alternatively, to prepare for the consequences should Exelon Generation not be able to meet that standard.

ICC Comments at 10. As will be explained below, this excerpt from the ICC's Comments illustrates that the ICC's market power concern is with *current* conditions in the ComEd service area, as well as conditions otherwise expected to exist in 2003. The excerpt also makes clear that the ICC is seeking *current* action from the Commission to address *current* market power conditions in northern Illinois. The action that the ICC is seeking is an immediate Commission declaration concerning the market power analysis standard that will be applied to the ComEd service area in 2003. Such an immediate declaration will induce market participants to take steps, by 2003, to eliminate current opportunities to exercise market power or to mitigate the negative effects of market power.

By taking such minimalist market-oriented action now, the Commission will reduce or remove the likely need to take major, dramatic, and heavy-handed regulatory action in 2003.

### 1. The Hub-and-Spoke Market Analysis Method Is Flawed.

The Commission cannot wait until 2003 as it proposes in the November 8 Order to review the Commission's "practice regarding market power analysis." Nov. 8, 2000, Order at 13. As the ICC explained at length in its Comments, the Commission's "practice regarding market power analysis," i.e., the hub and spoke method of market power analysis, is flawed *now* and these flaws must be addressed *now* in order to establish conditions conducive to effective market development. ICC Comments at 23-24. The ICC agrees with Commissioner Massey's views as reported in Inside FERC that the hub-and-spoke market analysis model is an "anachronism" and that the Commission should adopt a "more sophisticated" approach to market power analysis. "Massey, Hoecker Debate Best Analytical Method to Identify Market Power," Inside FERC, Nov. 27, 2000, at 1.

By ignoring transmission limitations and transmission constraints, the hub-and-spoke market analysis model does not take into account the physical feasibility of deliveries by alternative generation suppliers. ICC Comments at 23. Additionally, by ignoring unit operating costs, unit operating characteristics and unit dispatch, the hub-and-spoke model does not take into account the financial feasibility of deliveries by alternative generation suppliers. Id. In short, the hub-and-spoke model incorrectly defines the relevant geographic market for which supply alternatives are available. Consequently, market concentration results generated by the hub-and-spoke model are not meaningful, and conclusions about sellers' ability to exercise market power derived from those market concentration results cannot legitimately be used to assess the state of the market and should not be relied on to approve market-based rate requests. Id. at 24. Accordingly, the Commission's reliance on the results of Exelon's hub-and-spoke analysis at pages 6-7 of the Order to support approval of market-based rates within ComEd's service area is in error, and should be reversed.

**2. The "Delivered Price Test" is a More Appropriate Method of Market Analysis.**

Given the current degree of generation ownership/control concentration in northern Illinois, and the current limited transmission import capability into northern Illinois, conditions exist *now* that would permit Exelon to exercise market power in this geographic area. ICC Comments at 11-16. Indeed, applying a more appropriate "delivered price test" method of market analysis, ComEd's own testimony in the recent PECO/Unicom merger docket shows that ComEd owns or controls no less than 63.4% of the generation supply market within its service area and as much as 75.7% of that market. Direct Testimony of William H. Hieronymus, Applicants' Exhibit APP-306 at 1, Dkt. EC00-26-000 (filed Nov. 22, 1999)("Hieronymus Merger Testimony").

Compounding this high level of Exelon generation market ownership/control concentration is the factor of limited transmission import capability into the ComEd service area. In the merger proceeding, ComEd's witness Mr. Steven T. Naumann testified that the "first contingency incremental simultaneous import capability [into ComEd] for Summer 2001 is 4,500 MW." Direct Testimony of Steven T. Naumann, Exhibit No. APP-400 at 27, Dkt. EC00-26-000 (filed Nov. 22, 1999). By way of contrast, ComEd's expected peak load for 2001 is 20,000 MW. Hieronymus Affidavit at Exhibit No. WHH-2. This limited transmission import capability leaves a large amount of load within ComEd's service area that must, of necessity, be served by generators within ComEd's service area, and, of those generators, Exelon owns or controls the vast majority.

Under the assumptions adopted by Dr. Hieronymus, which include the HHI-reducing assumption of atomistic (i.e., perfect) competition for the amount of power imported over the transmission system, ComEd's own market share numbers lead to an HHI of between 4,177 and 5,791. Direct Testimony of William H. Hieronymus, Applicants' Exhibit APP-306 at 1, Dkt. EC00-26-000 (filed Nov. 22, 1999)("Hieronymus Merger Testimony"). By any accepted standard, these HHI numbers demonstrate a very high degree of market concentration and provide great opportunity for the exercise of market power.[2]

Insufficient factors exist to mitigate the ICC's market power concerns. As explained by the ICC in its Comments, the mitigating circumstance that Exelon *owns* only nuclear generating capacity within ComEd's service area cannot be relied on to assuage the ICC's concerns about existing market power conditions because the output of nuclear generators can be manipulated to manipulate the generation supply market. ICC Comments at 14-15. As additionally explained by the ICC, Exelon exercises significant levels of *control*, through contract, of unaffiliated non-nuclear generation within ComEd's service area that has characteristics that readily lend themselves to physical withholding and, thus, market manipulation. Id. at 15.

Therefore, the Commission's November 8 Order incorrectly concluded that the ICC's concern is a *future* concern. Nov. 8, 2000, Order at 13. In fact, if the Commission were to apply an appropriate market power analysis methodology such as the delivered price test to the *current* conditions in ComEd's service area, it would result in a finding of conditions conducive to the exercise of market power within ComEd's service area at this time. Therefore, the ICC's market power concern is a current one, as well as a future one.

### 3. Given the Existence of Short-Term Market Power Mitigating Factors Inherent in the Illinois Retail Access Program Design, the ICC Proposed a Light-Handed, Market-Oriented Remedy for Inducing Market Participants to Reduce or Eliminate Conditions Conducive to Exercise of Market Power by 2003.

The ICC could have legitimately requested that the Commission deny Exelon's request for market-based rates in the ComEd service area *now* based on the data and analysis summarized above and described in the ICC's Comments. However, as explained in the ICC's Comments and in this document below, the design of Illinois' retail direct access program *somewhat* mitigates the ICC's *immediate* concerns about the current state of the wholesale power market in ComEd's service area. The ICC, therefore, recommended adoption of a three-year market observation and monitoring period. ICC Comments at 10.

However, this three year market observation and monitoring period will only be useful in developing satisfactory market conditions in northern Illinois if Exelon and all other market participants are made aware *now* that the Commission will apply a meaningful method of market analysis, i.e., the delivered price test, to Exelon's updated market-based rate request in 2003. As the ICC explained in its Comments, in the intervening three years,

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[2] An HHI of 1800 or greater is generally characterized as representing a "highly concentrated" market conducive to the exercise of market power. See, e.g., Department of Justice Merger Guidelines or the Commission's own Merger Guidelines.

steps must be taken by Exelon, the ICC, the Commission and by all market participants to ensure that the current opportunities to exercise market power within ComEd's service area are eliminated or mitigated prior to 2003. The conditions conducive to the exercise of market power in ComEd's service area will not disappear by 2003 unless actions are taken now for their removal. In other words, unless the Commission acts now to establish an appropriate market power analysis standard to be applied in 2003, the conditions conducive to the exercise of market power will still exist and the circumstances mitigating the negative effects of that situation will be phasing out.

Therefore, the Commission must specify *now* the appropriate market power test that will be required to be satisfied in 2003, so that all interested parties have the correct incentive to pursue appropriate market power-reducing actions. As explained in its Comments, the ICC recommends immediate Commission adoption of the Order 592 Merger Policy Appendix A Delivered Price Test to be applicable to Exelon's 2003 market-based rates filing (at least with respect to ComEd's service area). ICC Comments at 24-28. If the Commission waits until 2003 to "take any action necessary based on the state of the market and the Commission's practice regarding market power analysis at that time" as proposed in its Order, see, Nov. 8, 2000, Order at 13, it will have missed the opportunity to induce market participants to take appropriate "voluntary" market power-reducing steps. Moreover, if the Commission does not act now to specify the appropriate market analysis methodology to be applied in 2003, the Commission will then be left only with undesirable heavy-handed regulatory tools to correct the market power problems likely to persist at that time. These heavy-handed regulatory tools are the same ones the ICC strained to avoid proposing in its Comments in this proceeding.

### 4. The ICC's Concern About Exelon Market Power is not *Completely* Mitigated in the Short-Run by the Illinois Retail Rate Freeze or the Phased-In Introduction of Retail Competition in Illinois.

#### a. Unbundled Retail Market Development During the Retail Rate Freeze.

It may be possible to demonstrate that, because of the statutory design for the introduction of retail direct access in Illinois, the *most* damaging effects of the Commission's flawed practice regarding market power analysis and the resulting utility opportunities to exercise market power may not be *exposed* until Illinois' retail rate freeze expires on January 1, 2005. ICC Comments at 17-20. Under Illinois law, retail customers in Illinois are entitled to continue to take bundled service from their existing utility at rates established by the Illinois legislature through January 1, 2005. Therefore, in a *static* sense, retail customers cannot be made worse off by Exelon's ability to exercise market power during the period of the retail rate freeze. However, in a *relative* sense, retail customers are made worse off if Exelon's ability to exercise market power dampens the development of a vigorous competitive market that might otherwise benefit retail customers as compared with the legislatively-established bundled retail rate. A flawed wholesale market blunts the benefits of competition that would otherwise be achievable in the unbundled retail market.

Given the limited transmission import capability into ComEd's service area, the high concentration of generation ownership/control within ComEd's service area and Exelon's vertical control over the transmission system, choice for the majority of retail customers within ComEd's service area may be more illusory than real. While retail customers may not be *actually* captive (through legislation or regulation) to Exelon generation after May 1, 2002, many will remain *practically* captive because of the limited availability of genuine wholesale generation supply alternatives. In effect, Exelon (either acting alone or in concert with other wholesale sellers) will be able to exercise market power over all of the residual demand not supplied by the limited alternatives. Consequently, everything that can be done by the ICC and by the Commission, either acting jointly or separately, to promote the development of an effectively competitive market, must be done.

As the ICC explained in its Comments, the concentration of ownership/control over generation supply within ComEd's service area and the limited amount of transmission capability into ComEd's service area, in association with Exelon's vertical control over the transmission system, does damage to the *development* of wholesale and retail competition by perpetuating barriers to some potential new entrants. Moreover, if the Commission waits until the market damage is exposed after the end of the Illinois retail rate freeze, there will be few or no tools left available for the Commission or the ICC to retroactively address the market damage actually done, and there will be no tools or few tools available for the Commission or the ICC to address *in a timely manner* the market damage on a going-forward basis.

Consequently, the ability to exercise generation market power in association with vertical control over the transmission system, creates conditions that are not conducive to the development of an effectively competitive wholesale and retail market. The damage done by those conditions may not be fully exposed until after the retail rate freeze is lifted on January 1, 2005. However, the Commission must act now to establish a regulatory framework that will lead market participants to take action during the interim period that will lead to the creation of an effectively competitive wholesale and retail market before January 1, 2005. If the Commission does not act now to establish the proper market analysis standard to be applied to future market power analyses, market participants will be discouraged from beginning to take the necessary steps to reduce the current market power problems.

#### b. Bundled Retail Rates and the Period After the Retail Rate Freeze.

The ICC is statutorily required to establish new bundled retail rates to be applicable to the period beginning January 2, 2005. 220 ILCS 5/16-111. The Applicants urged the Commission to rely on Illinois law to protect retail consumers. However, as the ICC explained in its Comments, this Illinois statutory provision is not sufficient, by itself, to protect bundled retail customers from the effects of the exercise of market power in the wholesale markets. ICC Comments at 17-20.

Even though the ICC retains the authority to conduct prudency reviews, once generating plants are transferred out of the utility either to an affiliate or a non-affiliate, the Federal filed rate doctrine requires the retail rates that the ICC establishes to be based on the price at which the distribution utility purchases power in the wholesale market. Id. at 17, 19 (citing Narragansett Electric Co. v. Burke, 381 A.2d 1358 (1977), cert. denied, 435 U.S. 972 (1978); Pike County Light & Power Co. v. Pennsylvania PUC, 465 A.2d 735, 738 (1983)). Accordingly, Commission-approved market-based rates, even though established through the exercise of market power or affiliate abuse, must be passed through into retail rates unless the ICC can demonstrate that specific transactions were imprudent. Id. Unfortunately, as previously recognized by the Commission, proof of imprudency will be very difficult to uncover because Exelon's ability to exercise market power should prevent the entry of alternative suppliers, thereby eliminating evidence of available, cheaper supply alternatives. Id. at 19-20 (citing Heartland Energy Services, Inc., 68 FERC ¶ 61,223, 1994 FERC LEXIS 1722 at 45-46 (1994)). Therefore, the Commission must take steps that are in addition to the Illinois Customer Choice Law to protect consumers.

### B. The Commission Erred in Waiving the Affiliate Code of Conduct in its Entirety

With respect to the affiliate code of conduct, the ICC advanced a two part recommendation in its Comments. Comments at 28-31. The ICC recommended that the Commission: (1) not grant Exelon's request to waive the employee separation and power market information aspects of the affiliate code of conduct; and (2) specify that any waiver of the inter-affiliate non-power goods and services transaction rules that the Commission does grant will be rescinded prior to the beginning of the test year that ComEd will utilize to establish bundled retail sales rates in Illinois to be applicable following the expiration of the statutorily mandated retail rate freeze in Illinois. Id. Without taking any account of the concerns or recommendations submitted in the ICC's Comments, the Commission approved Exelon's request to waive the inter-affiliate code of conduct based on the faulty premise that ComEd's retail customers are adequately protected by the retail rate freeze and by the introduction of direct retail access.[3]

[3] The Commission erred in its statement that "retail choice will become available to all Illinois customers between October 1, 1999 and December 31, 2000." Order at 10. Full retail access will not be achieved until residential customers obtain choice on May 1, 2002.

However, as the ICC explained in its Comments and in this document above, while the retail rate freeze may protect retail customers from harm in a static sense, the exercise of market power through affiliate abuse can still make retail customers worse off under the retail rate freeze *relative* to the condition that those customers could obtain, through exercise of choice, were a truly competitive market to develop during the rate freeze period. Similarly, the ICC explained that, given the high concentration of generation ownership/control within ComEd's service area and the limited transmission import capability into ComEd's service area, even the existence of full retail choice may not be sufficient to protect retail customers from market power exercised through affiliate abuse. The ICC went on to explain that the ICC's statutory authority to establish new bundled retail rates to be effective beginning January 2, 2005, will not be sufficient, because of the federal filed rate doctrine, to protect retail customers from the higher prices and reduced choices that would be the result of the exercise of market power through affiliate abuse. ICC Comments at 28-31.

Given these circumstances, the ICC legitimately could have recommended in its Comments outright rejection of Exelon's request to waive the inter-affiliate code of conduct. However, the ICC sought to act conservatively and to seek light-handed, market-oriented regulatory solutions wherever possible. The ICC, therefore, proposed in its Comments a partial/compromise solution to the issue of code of conduct waiver. The ICC recommended that, in order to continue to promote an environment conducive to the development of competition in ComEd's service area to the benefit of retail customers wishing to exercise their choice rights, the Commission *not* grant waiver of the employee separation and power market information aspects of the inter-affiliate code of conduct. In addition, to facilitate the ability of the ICC to establish reasonable new bundled retail rates for those retail customers wishing not to exercise their choice rights, the ICC recommended that the Commission *rescind* any waiver of the inter-affiliate non-power goods and services transaction rules that it grants in this proceeding prior to the beginning of the test year that ComEd will utilize to establish bundled retail sales rates that will be applicable following the expiration of the statutorily mandated retail rate freeze.

The Commission erred in not adopting the ICC's affiliate code of conduct recommendations.

## IV. Conclusion

WHEREFORE, for each and all of the aforestated reasons, the Illinois Commerce Commission respectfully requests that the Commission rehear its November 8, 2000, Order and adopt the recommendations submitted in the ICC's Comments as described above.

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Respectfully submitted,

ILLINOIS COMMERCE COMMISSION

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